

Review on Informal Business Sectors: An Emphasis on Its Practices and Opportunities

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Abstract

The informal economy has rapidly expanded world-wide especially in developing countries and it is continued being the only option for socio-economic problem of the community particularly for urban poor. The practice of informal activities is more or less the same both in developed and developing countries. Many studies have indicated the significance of the sector in solving various social and economic problems of the urban poor in general and in reduction of unemployment, providing low price goods and services and new job creation in particular. Despite the fact that, the nature of the informal sector as it is neither capital intensive nor requiring educational skills it is means that poor people are drawn more to this sector than the formal sector. However, the sector remain controversial concerning its negative or positive impacts and there is strong negative views about the sectors from formal business operators, academicians and other stakeholders and because of this, the sectors is not contributing as much as it can. Generally, there is no doubt about the substantial role of informal business in being the survival means and reducing poverty especially for urban poor communities and it requires the government support as it needs to be transformed to formalization, expanded and grow to micro level enterprise.

1. Introduction

The origin of the informal sector and the causes for its emergences are diverse (Portes et al., 1989). Between 1960s and 1970s, a significance section of the population in the developing countries was affected by poverty and working outside formal place which were later called as “informal”. During this time, Economic growth had no capacity to let down this problem as much as needed. The active labor force was growing faster than absorbing capacity of formal sector because of the rapid population growth and rural-urban migration. Still the sector is providing a livelihood and being survival option to a large section of the poor. Hence, the concept of the informal sector was born (Osvaldo, 2004).

The concept of “informality” has been a complicated issue to understand. Professional researchers forward some fundamental questions related to the origin and development of the informal sector which are critical to the understanding of the sector (Asmamaw, 1994). Various scholars are viewed the informal sectors as irregular economy (Ferman, 1973), and series of activities that occur outside of the formal arena (Jan. et al., 2002). Friedmann (1992) refers as the activities carried out and takes place without the state's knowledge, having an illegal character and; are unregistered under specific forms of national legislation, such as tax or social security laws (International Labour Office, 2002) and the part of the economy that does not fall under the purview of organized economic activities (Osvaldo, 2004). Its prevalence is more in third world counties and less in more developed countries (Sassen, 1989).

The notion of informality was first think up by international labor Organization study of urban labor market in Ghana (Hart, 1973). Beginning from this time the word was subsequently used by the ILO report of labor market condition of many Africa cities, in addition it was used by World Bank on reports and studies on urbanization and poverty (sethuraman, 1981).

An International Labour Office (ILO) report in Kenya first described that, lack of a shared view on the informal sector is largely related to the absence of a common view on the content and role of the informal sector (Tokman 2007). The western nations were considered the sector as a largely negative and obstacle to development, whereas the developing countries presented as best option for business development (Williams, 2007), and it's also the transitional base to become formal (ILO 2002).

Most of the time informal sector activities are home-based work, street vending and others. These are the only option for many urban poor people to secure their basic needs for survival. Benjamin, Golub, and Mbaye (2014) stated that informal activities consists of all activities operating outside the official legal and fiscal system, with a resulting lack of reliable statistical information. According to ILO-JASPA study (1990), the operators are also engaged in bakeries, grain mills, traditional cloth weaving, knitwear production, electrical equipment repair services, watch/clock repair services etc.

This unregistered sector absorbs a significant proportion of the economy and the large number of employs is nonagricultural workers in many developing countries, especially in Africa (Gelb et al. 2009). Informal economy is considered as the essential activities of both social and economic which found in many societies both in developing or developed countries and it represent sources of economic opportunity outside the domain of institutional regulation with activities legally or socially considered illegal (Portes et al, 2001)

As Organization for Economic Co-operation and Development (Gollin, 2002) indicated that, informal

activity is comprise around 42% of GDP in a sample of 31 low and lower-middle-income countries and 22% of GDP of higher-income countries from the sample of 32. The sector absorbs excess labor supply that is beyond the intake capacity of the formal sector (Gollin, 2002 and Ethiopia country report, 2014). Informal sector in developing countries represents about 50% or more of full-time workers and produces 40% to 60% of national income (Chickering & Salahadine, 1991). The significant portion of urban employment opportunities is created by informal business, but the environment which they are operating in is not suitable (Street Business Operators Task Force/Addis Ababa, 2000). However, the sector is serving as an important means for economic growth and development, particularly in poor countries where the formal sector is unable to absorb the largest part of working group (Sandra Johansson, 2010).

International Labor Organization indicated that, all new employment opportunities which are 85% around the world are created in the informal economy (United Nation Center for Human Settlement, 2006). According to World Bank indication, from 2005, 81.4% of youth in Ethiopia worked in the informal sector (compared to 43% for adults) and 12.5% were self-employed (compared to 49.6% for adults) (World Bank, 2008/09). Over half of the active youth labor force population is employed in informal sector and yet the informal sector is characterized by underemployment (ILO, 2012). In Ethiopia, 31.7% of urban employment is accounted by the informal sector (CSA 2012) and more than 40% are self-employed in the informal economy (TVET Strategy, 2008).

Therefore, the informal economy is priority option especially in developing countries where the labor force is large and rapidly growing (Sibongile. et al, 2013). The sector has an advantage of easy entry and low requirements for education, skills, technology, because of this the sector has a significant job and income generation capacity especially in the situation where unemployment is high, underemployment and poverty is the bottle neck for growth (Ahmadou, 2014).

For the governments, the informal sector might also be a remedy for unemployment problems, in addition to other economic question where the formal economy cannot absorb the majority of labor, due to its own limitations. Others even get to the point of seeing informality as a means to address the issue of unemployment and have created a favorable framework for promoting the informal economy. This is the reason for some governments to tolerate informality to a large extent (Omar 2006). Growth in economy particularly in employment is great in many developed countries, whereas in many developing countries, informal sector activities are often the remedy for employment problem for people who cannot participate in the formal sector employment (United Nations, 1995). The other fundamental socio-economic importance of the informal economy is serving as operating partner with the formal sector (Portes et al).

The diverse contribution of informal sector is not deniable. Whether in industrialized and less developed countries, it constitutes a major part of society but there have been no positive policy measures to promote the sector (Gibbon, 1995). And yet, the ideological controversy and debate surrounding its development have hidden the truth (Portes et al, 2001).

1.2 Rationale of the Review

From the policy and program perspective, in both 1st and 2nd Growth and Transformation Plan employment creation and poverty reduction taken as a priority and aims to create millions of jobs. It has also identified development and expansion of micro and small enterprises and increased financial support to Micro Finance Institutions as primary pathways to increase employment especially for youth. It is believed that, this is done through formalization of the diverse informal sector by upgrading them in to micro and small scale enterprise (Ethiopia country report ministerial conference on youth employment, 2014). In addition, a new target to the Millennium Development Goals stresses the role of productive employment and decent work for all in national and international development strategies (ILO, 2007).

Informality holds both positive and negative consequence on country. It is obvious that informality is a problem for the governments. The government is missing the income that can be collected from taxes and this is bottleneck to finance and provide the public services. In some countries the governments might be driving forces for businesses to informality because of the absence of good public services and this both sides of informality creates debate among different stakeholders (Omar, 2006).

In Ethiopia, recently the sector has given priority particularly regional towns and the capital of Addis Ababa where the majority of informal actors in the country exist and this is arise from the need to increase the role of micro and small enterprise in poverty reduction through formalization. In addition, there is motivation with the need of increasing their economic contribution, promoting better health and increasing security for the town population through formalization (Ethiopia country report for the 2014 ministerial conference on youth employment, 2014).

On the other hand, the role of informal economy in economic and social aspects, especially in urban poor communities' of developing countries account for up to half of economic activity and it is the livelihood for billions of people. Despite their contribution there are groups of scholars and a researcher those disagreed with

its contribution and forward that the effect of the sector on government income is overweight their contribution. Still their role in economic development remains controversial (Rafael and Andrei, 2014). A lot has been made by scholar or academician and government of developed countries about the sectors. Yet, there is a strong debate over the importance of informal sector among government, formal business operators, the community and the informal actors themselves (Asmamaw, 2007). Therefore, this is why the reviewer intends to review on the issue focusing the informal sector practice and opportunities.

1.3 Objective of the Review

The informal sector is ignored and receives little support from the government and other stakeholders. There is substantial ability of the informal sector contribution to poverty reduction through creation of employment and earnings. Many studies argue the need for government recognition, support and develop policies that can used to address the needs of the informal sector (Mlinga and Wells, 2002)

Despite the significant role of the informal sector in socio-economic development, its activities have been highly controversial in the government and the private formal sectors in view of their assumed illegality. This consequence a situation whereby the sector has been neglected from getting benefits and privileges required for development and further expansion (Asmamaw, 1996). Continued policy neglect, attempts to discourage informal operators and efforts to suppress them have always created negative aspect in the development of the sector and minimized the sector's role (Gibbon, 1995). In addition, the role of informal sectors in providing significant contribution particularly, in employment creation, poverty reduction and income creation, in general its economic contribution is less recognized by most of developing the countries. But, the role of the informal sectors especially for developing countries like Ethiopia is momentous where reduction of unemployment and poverty are the priority objectives of the government plan. Therefore, the objective of the paper/review is:

- ✓ To compromise the controversial issues about the informal sector contribution among the academicians and concerned bodies related to their contribution.
- ✓ To create awareness and bring about change of attitude on the part of academicians, governments and other stakeholders about informal business contribution, instead of commonly viewing the sectors as an abnormality/malfunction.

1.4 Methodology

In the initial point, the reviewer was focusing on comprised exploration of concepts, definitions and scoping of previous literature, and identifying and critically analyzing the debatable issues of the review after observing related articles and journals based on key words of the review. The review utilized a comprehensive search strategy using agreed key words. The reviewer tried to review the subject matter focusing on number of countries. This paper is prepared based on a review of different research paper, reviews, journals conducted in different countries those conducted based on different scientific methodology and using various statistical techniques. Reviewed papers and journals were conducted using both primary and secondary data.

Moreover, in order to understand the practices, opportunities and controversial issues surrounding the informal sector, a methodological framework that made effective use of available secondary information. The study has reviewed various literature on the operation and development of the informal sector in the developed and developing countries and evaluated policy-oriented studies on poverty alleviation strategies and informal sector activities in Ethiopia.

2. Literature review

2.1 Opportunities of informal Business/ Economy

2.1.1 Introduction

Informality is part of the daily life of individuals and households in urban poor people. It is the means where production of goods and service and distribution functions are take place. The informal economy is the place where an entrepreneur is emerged and self-employment is growing faster. It consists of sets of survivalist those are marginalized from the normal economy and characterized by poor, uneducated. They offer the potential for independent growth workers and usually play a subordinate role with formal institutions (Portes et. al, 2001).

The importance of informal business activities in the economic development of poor countries has been recognized in nearly all countries of the world (Imani, 1993 and Harper 1984).

2.1.1 Employment Opportunities of Informal Business

The role of informal sector is multidimensional and serves as a significant breeding ground for entrepreneurs with opportunities for self-employment (Gibbon, 2002). The size of the informal sector is 4-6% in high income countries to over 50% in low-income countries (World Bank Group).

Informal employment accounts for a substantial portion of employment today. In countries where there is no social benefits related to unemployment, the only alternative for unemployed individual is engaging in informal sector employment (Chen et al, 2005). Nowadays, the informal sector is considered as important source

of employment in many African countries more than formal one which is only contributing 25% of the total employment (Aboagye 1989 and ILO and WIEGO, 2012).

In the past decade, informal economy is estimated to have, 80 per cent of non-agricultural employment, over 60 per cent of urban employment and over 90 per cent of new jobs in Africa (Charmes, 2000). Besides, ILO (2002) indicated that, the informal sector contribute more than 80% of total employment, 90% of new jobs and about half of national output in African low income countries and this has significance effect on productivity and economic revenues. In sub-Saharan Africa it accounted 21% of total labor force; represents 92 percent of women nonagricultural employment (Charmes, 2000). Generally, estimates show that, the sector comprises more than half of non-agricultural employment in most developing countries: 82 per cent in South Asia, 65 per cent in East and Southeast Asia excluding China and 51% in Latin America (ILO and WIEGO, 2012, Chen, 2001 and Verdera, 2001).

The informal sector, therefore, plays significant role for the majority of unemployed society especially for African peoples (UNECA, 1995) and through its diversified activities, the informal sector is able to absorb excess labor force in the economy (Ferej, 1996).

2.1.2 The Role of Informal Business in Providing Goods and Services

The informal sector is important not just as a source of employment but also for the production of goods and services (ILO and WIEGO, 2012). Informal workers provide basic goods and services which are cheap (very low price) and accessible to the majority of the low-income earners (Asmamaw, 1994, Kyoko, 2006 and Sally, 2014). The goods and services produced and provided by informal sector is helping the poor through consumption as well as more wealth households (Chen et al, 2005). They provide a very valuable service and goods very close to customers and plays significant role in supporting personal or household consumption through generating income (Sally R, 2014). Their roles in service provision, providing cheap food for the urban population and improving market access in residential area are substantial (Kyoko, 2006).

2.1.3 The Role of Informal Business in Poverty Alleviation

Informal sector activities play important role in poverty mitigation efforts by providing the survival means for households those are poor and disadvantaged groups (UNECA, 1996). The informal sector is the key in poverty reduction (Chen et al, 2005); and often the only source of income for the poor (UNECA, 1996 and Chen et al, 2005). Thus, another important contribution of the sector is income generation for the underprivileged. ILO's estimated the average contribution of the informal sector to the total GDP is found to be around 20%. This is an indication of the sector's role in meeting the basic needs of the poverty-ridden population of Africa in general and for developing countries like Ethiopia in particular (UNECA, 1996).

The informal sector has no doubt in making precious contribution to economic and social life through provision of employment, generation of income, development of skills and other social services to those neglected and marginalized groups. In Ethiopia (Addis Ababa) the informal sector takes up 43% of total establishments in the country and absorbing 42% of the national work force (Street Business Operators Task Force/Addis Ababa, 2000, Addis Ababa City Administration, 2000, and Yitbarek, 2001).

Generally, informal economy has economic contribution like bringing goods and service close to customers, providing this goods and service at low prices, provide people with their needs, providing jobs and reduce unemployment. In addition, they can alleviate poverty and give food to poor and hungry people (Sibongile. et. al, 2013).

2.2 Implication of the Review

In many countries, variety of research is conducted about informal economy and broad range of policy recommendations has been made. But, little is done about the sector in Ethiopia and this is incite for academicians for further studies and come up with new ideas to contribute over the dilemma and promote the positive aspects of the informal economy and represses the negative ones.

The awareness and attitude of the communities and other stakeholders is not yet changed about informal economy, therefore awareness creation program is highly demanded and the sectors role needs to be well known and sustained.

The review finds that, the large numbers of informal activities are operating without having fixed location. They are not recognized, regulated and supported by the government. Therefore, enabling environment needs be created with appropriate policies which support their activities and the initiation needs to be continued and transform them in to licensed business.

To sustain their contribution, policies and positive measures should unlock these people from their low-productivity activities, enable them to be more productive and provide them with economic opportunities.

The sector has no any formal financial sector support or credit availability, so there is an indication that the sector can contribute beyond this if there is credit services.

Finally, the review shows the partnership between the formal and informal sectors has its own contribution. But, more specifically, the real linkage between both sectors is what needs further studies especially in

developing countries like Ethiopia.

2.3 Conclusion

The breadth of literature reviewed for this paper testifies to the significance of informal economy in urban areas. Therefore, the role of urban informal business especially in developing countries is undeniable facts and a lot of evidence suggests that the informal sector contribution is very much a reality not only in developing countries but also in newly industrialized countries. Particularly, the sector is helping the urban poor people in providing employment opportunities, cheap goods and services; and improving income levels, in general it is helping the marginalized groups of urban people to cope with their poverty. Besides, sector has no doubt in its economic contribution poor countries like Ethiopia. Even though, there are a lots of research evidence which support its significant role in development as well as in poverty alleviation efforts, the sector has got little support and recognition from governments.

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